

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Refer Reply To:
CC:PSI:B04
PLR-133106-08
Date:
January 22, 2009

In Re:

Legend

Decedent	=
Spouse	=
Date 1	=
Trust	=
Executor	=
Trustee	=
Accounting Firm	=
Law Firm	=
State Statute	=

Dear

This letter is in response to a letter dated July 22, 2008, from your authorized representatives, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever a marital trust into two separate trusts for purposes of the generation-skipping transfer (GST) tax and to make a reverse qualified terminable interest property (QTIP) election under § 2652(a)(3) of the Internal Revenue Code with respect to one of the separate trusts.

Facts

The facts and representations are as follows:

Decedent died on Date 1, survived by Spouse and children. Under the terms of Decedent's will, if his Spouse should survive him, all of his tangible personal property was to be distributed outright to her. The balance of Decedent's estate was to be held in trust

(Trust), and all of the income from Trust was to be distributed to Spouse quarter-annually during her lifetime. In addition, Trustee was given the power to distribute any part of the principal of Trust to Spouse during her life. Trust will terminate at Spouse's death, and the principal is to be distributed to Decedent's issue.

Trustee, as Executor of Decedent's estate, hired Accounting Firm to prepare Decedent's Form 706, United States Estate (and Generation-Skipping) Tax Return, which was timely filed on extension.

On Schedule M of the Form 706, a QTIP election was made for the Trust. Accountant who prepared the return failed to file a Schedule R (Generation-Skipping Transfer Tax) and did not advise the estate to sever the QTIP Trust into an exempt and nonexempt trust for GST purposes, to make the reverse QTIP election for the GST exempt trust, or to allocate Decedent's available GST exemption to the GST exempt trust. The errors were discovered when Law Firm reviewed the return for other purposes.

Analysis

State Statute provides that notwithstanding any contrary provision of law, unless expressly prohibited by the terms of the disposing instrument, the trustee of trust (which term as defined in paragraph (g) of this section may mean the executor or administrator) is authorized without prior court approval or the consent of the persons interested to establish two or more separate trusts in order to segregate property held in trust in which a spouse or surviving spouse has a qualifying income interest with respect to which an election has been or will be made in whole or in part under section 2056(b)(7), 2056A or 2523(f) from property with respect to which no election has been or will be made. The trustee may also separate a trust to segregate property held in trust which is or would be exempt from GST tax from property which is not so exempt, so that one or more trusts will have an inclusion ratio of zero.

Section 2001(a) imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate shall, except as limited by § 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Under § 2056(b)(1), no deduction is allowed for an interest passing to the surviving spouse if, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, the interest will terminate or fail.

Under § 2056(b)(7)(A), "qualified terminable interest property" is treated as passing to the surviving spouse for purposes of § 2056(a) and no part of the property is treated as passing to any person other than the surviving spouse. Qualified terminable interest property is defined under § 2056(b)(7)(B)(i) as property: (1) which passes from the decedent to the surviving spouse; (2) in which the surviving spouse has a qualifying

income interest for life; and (3) to which an election under § 2056(b)(7)(B)(v) applies. Under § 2044, property subject to a QTIP election for which a deduction is allowed under § 2056(b)(7), is includible in the surviving spouse's gross estate on that spouse's subsequent death.

Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if: (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property; and (II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Section 2056(b)(7)(B)(v) provides that an election under § 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by § 2001. Such an election, once made, shall be irrevocable.

Section 2601 imposes a tax on every generation-skipping transfer (GST) made by a transferor to a skip person. A GST is defined under § 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate. Section 2641(a) provides that the term "applicable rate" means with respect to any GST, the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a generation-skipping transfer is generally defined as the excess of 1 over the "applicable fraction". The applicable fraction, as defined in § 2642(a)(2), is a fraction, the numerator of which is the amount of GST exemption under § 2631 allocated to the trust (or to property transferred in a direct skip), and the denominator is the value of the property transferred reduced by the sum of any federal estate tax or state death tax actually recovered from the trust attributable to such property and any charitable deduction allowable under § 2055 or § 2522 with respect to such property.

Under § 2631(a), for purposes of determining the inclusion ratio, every individual is allowed a GST exemption amount which may be allocated by the individual (or his executor) to any property with respect to which the individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, is irrevocable.

Section 2632(a)(1) provides that an individual's GST exemption may be allocated at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such return is required to be filed.

Under § 26.2632-1(d)(1) of the Generation-Skipping Transfer Tax Regulations, an allocation of a decedent's available GST exemption by the executor of the decedent's estate is made on Form 706 filed on or before the date prescribed for filing the return by § 6075(a) (including any extensions granted). An allocation of GST exemption with respect to property included in the gross estate of a decedent is effective as of the date of death.

Section 2632(e)(1) provides that any portion of an individual's GST exemption which has not been allocated within the time prescribed by § 2632(a) is deemed to be allocated as follows: (A) first, to property which is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

Section 26.2632-1(d)(2) provides that a decedent's unused GST exemption is automatically allocated on the due date for filing Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. Unused exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)), on the basis of the value of the property as finally determined for purposes of the estate tax (chapter 11) value, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST exemption is allocated pro rata (subject to the rules of § 26.2642-2(b)) on the basis of the chapter 11 value of the nonexempt portion of the trust property to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made. However, no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the new trust.

Section 2642(b)(2) provides, generally, that if property is transferred as a result of the death of the transferor, the value of the property for purposes of determining the inclusion ratio under § 2642(a)(1) shall be the value of the property as finally determined for estate tax purposes.

Section 2642(g)(1)(A) provides, generally, that the Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make an allocation of GST exemption described in § 2642(b)(1) or (2), and an election under § 2632(b)(3) or (c)(5). Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of § 2642(g)(1)(A), which was enacted into law on June 7, 2001.

Under § 2652(a)(1) and § 26.2652-1(a)(1), the "transferor" of the property for GST tax purposes is the individual with respect to whom the property was last subject to federal estate or gift tax. However, under § 2652(a)(3), in the case of a trust for which a deduction was allowed under § 2056(b)(7), the decedent's estate may elect to treat all of the property in the trust as if the § 2056(b)(7) election had not been made for purposes of the GST tax (i.e., a "reverse QTIP election"). Accordingly, the decedent, and not the surviving spouse, is treated as the transferor of the property for GST tax purposes. The reverse QTIP election is irrevocable and is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies. Under § 26.2652-2(b), the reverse QTIP election is made on the return of tax on which the QTIP election is made.

Under § 26.2654-1(b)(1), the severance of a trust that is included in the transferor's gross estate (or created under the transferor's will) into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or local law; and

(A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust;

(B) The severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the Federal estate tax return (including extensions actually granted) for the estate of the transferor; and

(C) The new trusts are severed on a fractional basis. If severed on a fractional basis the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trust may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding. See § 26.2654-1(b)(4) Example 3.

Under § 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute).

Notice 2001-50, 2001-34 I.R.B. 189, provides, in part, that under § 2642(g)(1)(B), the time for allocating the GST exemption to transfers at death is to be treated as if not expressly prescribed by statute. The Notice further provides that taxpayers may seek an extension of time to make an allocation described in § 2642(b)(2) under the provisions of § 301.9100-3.

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer has acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

In this case, because a QTIP election was made on Decedent's Form 706, the assets of Trust will be includible in Spouse's gross estate pursuant to § 2044. Spouse will be considered the transferor of such property for GST tax purposes, thereby precluding the allocation of any of Decedent's GST exemption to the Trust. However, if Decedent's estate is granted an extension of time to sever the Trust into a GST exempt trust and a GST nonexempt trust and to make a reverse QTIP election with respect to the GST

exempt trust, Decedent will be treated as the transferor of the GST exempt trust for GST tax purposes.

Based on the facts presented and representations made, we have determined that the standards of §§ 301.9100-1 and 301.9100-3 have been met. Therefore, an extension of time is granted until 60 days from the date of this letter to sever the Trust into a GST exempt trust and a GST nonexempt trust and to make a "reverse" QTIP election with respect to the GST exempt trust.

The reverse QTIP election and any allocation of GST exemption should be made on a supplemental Form 706 (United States Estate (and Generation-Skipping Transfer) Tax Return). The supplemental Form 706 should be filed on behalf of Decedent's estate with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Curt G. Wilson
Associate Chief Counsel
(Passthroughs & Special
Industries)

Enclosures:

Copy for § 6110 purposes
Copy of this letter

cc